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Message Text

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USIA-06 AID-05 COME-00 EB-08 FRB-03 TRSE-00
XMB-02 OPIC-03 LAB-04 SIL-01 OMB-01 STR-07 CEA-01
DOE-11 SOE-02 OES-07 DLOS-09 /123 W
----------125364 020145Z /14
P 012335Z FEB 78
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PARIS FOR USOECD

DEPT. PASS CEA, TREAS, FRB

E.O. 11652:N/A
TAGS: ECON, EFIN, CA
SUBJECT: JANUARY 26 FEDERAL/PROVINCIAL FINANCE MINISTERS' CONFERENCE: MEDIUM TERM PROSPECTS AND ISSUES.

REF: (A) VANCOUVER 127; (B) OTTAWA 10555

1. SUMMARY. FINANCE MINISTER CHRETIEN OUTLINED MEDIUM TERM MACRO-ECONOMIC SCENARIO FOR REDUCTION OF INFLATION AND UNEMPLOYMENT AT MEETING OF FEDERAL/PROVINCIAL FINANCE MINISTERS JANUARY 26-27. GOAL ANNOUNCED OF 3.5 PERCENT INFLATION RATE AND 5.5 PERCENT UNEMPLOYMENT RATE BY END OF 1981, WITH AVERAGE 5.5 PERCENT ANNUAL RATE OF REAL GROWTH OVER INTERIM. CHRETIEN STRESSED CLOSE COOPERATION BETWEEN FEDERAL AND PROVINCIAL GOVERNMENTS AND PUBLIC AND PRIVATE SECTORS
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REQUIRED TO REDUCE INFLATION IF GROWTH AND EMPLOYMENT GOALS TO BE ACHIEVED. HE STRESSED NEED TO MONITOR CLOSELY WAGE AND PRICE DEVELOPMENTS IN POST CONTROL PERIOD, ESPECIALLY PUBLIC SECTOR WAGES, THROUGH COOPERATIVE GOVERNMENT POLICIES SHORT OF CONTROLS. NEED FOR ENERGY INVESTMENT WAS STRESSED. DOOR LEFT OPEN FOR FURTHER FISCAL STIMULUS IN SPRING BUDGET. MACRO-ECONOMIC SCENARIO STRESSING NEED FOR COMBINATION OF

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MEDIUM TERM DEMAND MANAGEMENT, PRICE AND INCOMES, BASIC STRUCTURAL, AND SPECIFIC SECTORAL POLICIES TO ATTACK PROBLEMS COMPLIMENTS SECTORAL STUDIES AND FEDERAL/PROVINCIAL MEETINGS UNDERWAY LEADING UP TO FIRST MINISTERS' MEETING FEBRUARY 13-15. END SUMMARY.

2. MEDIUM TERM SCENARIO. JANUARY 26 FEDERAL/PROVINCIAL FINANCE MINISTERS' MEETING WAS MOST IMPORTANT STEP TO DATE IN PREPARATION FOR FIRST MINISTERS' ECONOMIC SUMMIT SET FOR FEBRUARY 13-15. FINANCE MINISTER CHRETIEN LAUNCHED MEETING WITH SPEECH SETTING OUT PRINCIPLE RESULTS OF GOC ANALYSIS (BY DEPARTMENT OF FINANCE) OF MEDIUM TERM PROSPECTS, PROBLEMS AND POLICY REQUIREMENTS. AT MEETING, GOC CIRCULATED DISCUSSION PAPER (TO BE MADE PUBLIC SOON) WHICH OUTLINED GOC VIEWS IN CONSIDERABLE DETAIL AND EXAMINED RISKS IMPINGING ON CANADIAN ECONOMIC PERFORMANCE OVER NEXT FIVE YEARS.

3. ACCORDING TO CHRETIEN, GOC MEDIUM TERM ANALYSIS LED TO FOLLOWING CONCLUSIONS:
(A) CANADA COULD ACHIEVE AVERAGE ANNUAL REAL GNP GROWTH OF 5.5 PERCENT BETWEEN 1978 AND 1981, COMPARED WITH ESTIMATED 4.5 PERCENT GROWTH OF POTENTIAL OUTPUT. PREVIOUS OFFICIAL ESTIMATES HAD PUT GROWTH OF POTENTIAL AT 5 PERCENT. DOWNWARD REVISION IS DUE PRIMARILY TO PROJECTED SLOWER GROWTH OF LABOR FORCE. IN GOC VIEW, OTHER FACTORS SUCH AS INCREASE IN RELATIVE PRICE OF ENERGY, SHIFT IN COMPO-
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SITION OF OUTPUT TOWARD SERVICES, SHOULD NOT ACT TO REDUCE FUTURE TREND GROWTH OF PRODUCTIVITY. NEVERTHELESS, GOC HAS MADE "CONSERVATIVE" ASSUMPTION THAT FUTURE TREND GROWTH OF PRODUCTIVITY WILL BE 2 PERCENT, COMPARED WITH HISTORIC AVERAGE OF 2.2 PERCENT.

IN SEPARATE STATEMENT, CHRETIEN REITERATED OFFICIAL FORECAST OF 5 PERCENT REAL GROWTH THIS YEAR, THEREBY IMPLYING THAT AVERAGE GROWTH RATE BETWEEN 1979 AND 1981 IS EXPECTED TO BE ABOVE 5.5 PERCENT. (GROWTH TO BE LED BY EXPORTS AND INVESTMENT, ESPECIALLY ENERGY INVESTMENT. GOC SEES PRESENT CAPITAL STOCK IN MANUFACTURING AS MORE THAN ADEQUATE, MAIN PROBLEM BEING EXCESS CAPACITY.)

(B) WITH GNP GROWTH AVERAGING 1 PERCENTAGE POINT ABOVE POTENTIAL, UNEMPLOYMENT RATE COULD BE BROUGHT DOWN TO 5.5 PERCENT BY 1982 FROM CURRENT LEVEL OF 8.5 PERCENT. GOC DOES NOT, HOWEVER, EXPECT UNEMPLOYMENT RATE TO FALL ON AVERAGE IN 1978. SUBSEQUENTLY, FASTER GROWTH OF OUTPUT AND DECELERATION OF GROWTH IN LABOR FORCE WOULD BE EXPECTED TO BRING UNEMPLOYMENT RATE DOWN BY ABOUT 0.75 PERCENTAGE POINT ANNUALLY IN PERIOD TO 1982. THUS, BETWEEN 1979 AND

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1982 UNEMPLOYMENT RATE WOULD FALL BY ABOUT 0.6 PERCENT FOR EVERY PERCENTAGE POINT BY WHICH ACTUAL GROWTH RATE EXCEEDS THAT OF POTENTIAL. GROWTH FAST ENOUGH TO REDUCE UNEMPLOYMENT, BASED IN LARGE PART ON MORE STIMULATIVE FISCAL POLICY STANCE THAN AT PRESENT, IS DEPENDENT ON LOWER WAGE/PRICE INCREASES. GROWTH, EMPLOYMENT SCENARIO SEEMS MOST VULNERABLE TO OVERLY OPTIMISTIC ASSUMPTIONS RE. WAGE/PRICE PERFORMANCE.

(C) INFLATION RATE (CPI) COULD BE REDUCED TO 3.5 PERCENT BY 1981. IMPORTANT TO ACHIEVEMENT OF THIS TARGET IS REDUCTION OF RATE OF INCREASE IN UNIT LABOR COSTS TO 3.4 PERCENT BY 1981. ALTHOUGH OFFICIAL PRODUCTIVITY PROJECTIONS ARE NOT AVAILABLE, IT IS CLEAR THAT SUBSTANTIAL DECELERATION OF

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NOMINAL WAGE INCREASES WILL BE REQUIRED TO EFFECT A REDUCTION TO 3.4 PERCENT OF UNIT LABOR COST INCREASES.(UNIT LABOR COSTS ROSE BY 7.7 PERCENT LAST YEAR.)

4. STRUCTURAL AND SECTORAL ISSUES: WHILE GOC APPARENTLY DWEALT ON MACRO-ECONOMIC OUTLOOK, IT ALSO EMPHASIZED THAT REALIZATION OF MACRO TARGETS WOULD REQUIRE PROGRESS TOWARD RESOLUTION OF STRUCTURAL AND SECTORAL PROBLEMS. CHRETIEN NOTED THAT SECTORAL STUDIES WERE NEARING COMPLETION. (FEDERAL/PROVINCIAL MEETING ON MANUFACTURING SECTOR WAS HELD JANUARY 28, SEE SEPTEL.)

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5. POLICY REQUIREMENTS. CHRETIEN INDICATED THAT POLICY ACTIONS IN FOUR DISTINCT AREAS WOULD BE REQUIRED OVER MEDIUM TERM:

(A) DEMAND MANAGEMENT POLICIES: GOC PROJECTIONS ASSUME CONTINUED RESTRAINT IN GROWTH OF GOVERNMENT SPENDING, INTERPRETED IN CHRETIEN'S STATEMENT TO MEAN THAT REAL PUBLIC
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EXPENDITURE SHOULD RISE AT RATE OF INCREASE IN POTENTIAL OUTPUT (4.5 PERCENT). DEPARTMENT OF FINANCE OFFICIALS TOLD EMBOFFS THAT CHRETIEN'S STATEMENT WAS WRONG ON THIS POINT AND THAT PLANNED GROWTH OF REAL GOVERNMENT SPENDING WAS CONSIDERABLY LESS THAN GROWTH RATE OF POTENTIAL. CHRETIEN INDICATED THAT FISCAL POLICY WOULD HAVE TO "BE STRONGLY STIMULATIVE THROUGHOUT THE RECOVERY" AND POINTED TO NEED TO "MAINTAIN AS STIMULATIVE FISCAL POLICY AS IS FINANCIALLY AND PSYCHOLOGICALLY PRUDENT."

DEPARTMENT OF FINANCE OFFICIALS ALSO INDICATED THAT GOC PROPOSED THAT PROVINCIAL GOVERNMENTS ACT TO STIMULATE CONSUMPTION NOTING THAT PROVINCES WERE IN BETTER FINANCIAL POSITION WITH COLLECTIVE DEFICITS SMALLER IN RELATIVE TERMS THAN DEFICIT OF FEDERAL GOVERNMENT. SPECIFICALLY, GOC PROPOSED TEMPORARY TAX CUTS BY PROVINCES TO GIVE BOOST TO GROWTH IN SHORT RUN. LATTER (WITH EXCEPTION OF SASKATCHEWA WERE COOL OR OPPOSED TO PROPOSAL. ONTARIO TREASURER DARCY MCKEOUGH CALLED FOR RESTRAINED GROWTH OF PUBLIC SECTOR. HE PROPOSED THAT GROWTH OF PUBLIC SECTOR EMPLOYMENT BE HELD TO 1 PERCENT AND THAT REAL GROWTH OF PUBLIC SPENDING BE KEPT DOWN TO 2 PERCENT. WHILE MCKEOUGH WAS MORE SPECIFIC THAN MOST PROVINCIAL FINANCE MINISTERS, HE APPEARED ACCURATELY TO REFLECT THEIR SPENDING MOOD. UNCHARACTERISTICALLY, JACQUES PARIZEAU OF QUEBEC ACKNOWLEDGED FINANCIAL CONSTRAIN ON FEDERAL GOVERNMENT'S ABILITY TO FURTHER STIMULATE THE ECONOMY.

(B) PRICE AND INCOMES POLICIES: GOC STRESSED NEED TO ESTABLISH EFFECTIVE MECHANISM TO MONITOR WAGE/PRICE INCREASES WITH ONSET (APRIL 14) OF AIB PHASEOUT. IT SOUGHT AGREEMENT FROM PROVINCIAL MINISTERS TO LIMIT GROWTH OF PUBLIC SECTOR COMPENSATION TO STRICT COMPARABILITY WITH
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PRIVATE SECTOR INCREASES. PROVINCIAL MINISTERS AGREED IN PRINCIPLE ON BOTH POINTS, BUT EMPHASIZED THAT THESE MATTERS

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CAME WITHIN PROVINCIAL JURISDICTION. FEDERAL AND DROVINCI
GOVERNMENTS ARE APPARENTLY NO CLOSER TO AGREEMENT ON STRUC
TURE OF POST-CONTROL REGIME THAN THEY WERE AT CONCLUSION
OF JANUARY 21 LABOR MINISTERS' CONFERENCE.

(C) FRAMEWORK POLICIES: CHRETIEN UNDERLINED NEED TO
DEVELOP OR IMPROVE POLICIES IN SUCH AREAS AS COMMERCIAL
POLICY, INDUSTRIAL RELATIONS, LABOR MARKET POLICY, ENERGY
POLICY, ENVIRONMENTAL POLICY AND REGIONAL POLICY. EMPHASIS
WOULD BE PLACED PRODUCING RECONCILATION OR APPROPRIATE
BALANCE AMONG SEVERAL COMPETING OBJECTIVES.

(D) SECTORAL POLICIES. UPCOMING MEETINGS ON SPECIFIC
SECTORS WOULD AIM AT DEVELOPING INITIATIVES FOR IMPROVING
LONGER TERM ECONOMIC PROSPECTS FOR OVERALL ECONOMY.CHRETIE
CITED AS EXAMPLE, RECENT MOVE TO ENCOURAGE DOMESTIC AIR
TRAVEL AND PLANS TO UTILIZE FULLY THE 200 MILE FISHING ZONE
AT JANUARY 29 MEETING OF FEDERAL AND PROVINCIAL INDUSTRY
MINISTERS, LATTER WERE REPORTEDLY COOL TO GOC PROPOSAL FOR
TRIPARTITE (BUSINESS, LABOR, GOVERNMENT) FOLLOW-ON MEETING
ON SPECIFIC SECTORS. (SEE SEPTEL).

COMMENT: IN CONVERSATION WITH EMBOFFS PRIOR TO FINANCE
MINISTERS' MEETING, DEPARTMENT OF FINANCE OFFICIALS EXPRES-
SED HOPE THAT PROVINCIAL GOVERNMENTS WOULD LATCH ONTO GOC
MEDIUM SCENARIO AS BLUEPRINT FOR FUTURE. THEY WERE NOT
OPTIMISTIC, HOWEVER, THAT THIS RESULT COULD BE ACHIEVED.
RATHER, GOC THOUGHT AN ACCEPTABLE AND MORE LIKELY OUTCOME
WOULD BE FOR FINANCE MINISTERS TO CONSIDER GOC EFFORT AS
A USEFUL CONTRIBUTION TO PROCESS OF FEDERAL/PROVINCIAL
CONSULTATION ON ECONOMIC PROSPECTS AND POLICIES. OFFICIALS
FEEL THAT THIS GOAL HAS BEEN MET. PROVINCES ACCEPTED GOC
INPUT AS USEFUL FIRST STEP AND ARE NOW CONCENTRATING ON

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DEFINING REGIONAL FOCUS OF MACRO AND SECTORAL STUDIES. IN ADDITION, FEDERAL AND PROVINCIAL GOVERNMENTS ARE IN THE PROCESS OF REACHING AGREEMENT ON SPECIFIC POLICY CONCLUSION AND RECOMMENDATIONS TO BE FORWARDED TO FIRST MINISTERS BEFORE FEBBUARY 13-15 FEDERAL/PPOVINCIAL ECONOMIC SUMMIT.
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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 jan 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: FINANCE, MINISTERIAL MEETINGS, PROVINCIAL OFFICIALS
Control Number: n/a
Copy: SINGLE
Draft Date: 01 feb 1978
Decaption Date: 01 jan 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 20 Mar 2014
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1978OTTAWA00512
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Expiration:
Film Number: D780049-0244
Format: TEL
From: OTTAWA
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1978/newtext/t197802106/aaaadlzm.tel
Line Count: 292
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 6d6808ce-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 6
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
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Reference: 78 VANCOUVER 127, 78 OTTAWA 10555
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 05 may 2005
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: N/A
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 3442910
Secure: OPEN
Status: NATIVE
Subject: JANUARY 26 FEDERAL/PROVINCIAL FINANCE MINISTERS\' CONFERENCE: MEDIUM TERM PROSPECTS AND ISSUES.
TAGS: ECON, EFIN, CA
To: STATE
Type: TE
vdkvgwkey: odbc://SAS/SAS.dbo.SAS_Docs/6d6808ce-c288-dd11-92da-001cc4696bcc
Review Markings:
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